No. 92-1370

In The

# Supreme Court of the United States

October Term, 1993

BFP, A Partnership,

*Petitioner,*

v.

THE RESOLUTION TRUST CORPORATION As Receiver for IMPERIAL FEDERAL SAVINGS & LOAN ASSOCIATION; PAUL OSBORNE; WILLIAM LITTLE; DENNIS ROY; ARTHUR RITZ; JOSE CRUZ; RICHARD MARCZ,

*Respondents.*

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

## BRIEF OF THE AMERICAN COUNCIL OF LIFE INSURANCE AND THE AMERICAN COLLEGE OF REAL ESTATE LAWYERS AS AMICI CURIAE IN SUPPORT OF RESPONDENTS


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## QUESTION PRESENTED

Was the Ninth Circuit's holding that the "reasonably equivalent value" standard set forth in Section 548 of the Bankruptcy Code was satisfied by the price received at a noncollusive, regularly conducted foreclosure sale a permissible interpretation of Section 548?

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## STATEMENT OF INTEREST OF AMICI CURIAE[1]

The American Council of Life Insurance (the "Council") is a nonprofit voluntary trade association, the membership of which totals 634 legal reserve life insurance companies doing business throughout the United States. The member companies of the Council account for 89.9 percent of the legal reserve life insurance in force in this country and afford protection to approximately 140 million insureds. At the end of 1992, life insurance companies held $247 billion of long-term debt secured by mortgages on real property in the United States, which represented 15 percent of the total assets held by life insurance companies in that year.[2] A reversal of the decision below would have a serious adverse effect on these mortgage investments. On the other hand, life insurance companies have billions of dollars invested in unsecured corporate obligations that would be benefitted by a reversal of the decision below. Therefore, the Council is in a unique position to advise as to the proper resolution of the issue now before this Court.

The American College of Real Estate Lawyers ("ACREL") is a nonprofit corporation, organized on April 28, 1980, for the purpose of, *inter alia*, gathering together lawyers "to improve and reform real estate law and practice." (ACREL Articles of Incorporation at 2). ACREL's membership consists of approximately 800 attorneys from nearly every state and the District of Columbia who have concentrated their practice in real estate law for a period of ten years or more, and law school professors specializing in the field of real estate law. In addition, members elected to ACREL must have demonstrated a willingness to devote time to improving real property law through writing, teaching or participation in

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[1] Amici have obtained the permission of both parties in this case to file this brief. Written evidence of such permission is being submitted concurrently herewith.

[2] American Council of Life Insurance, 1993 Life Insurance Fact Book Update (ACLI, Washington, D.C. 1993).

professional association activities. ACREL's membership represents the entire spectrum of the real estate industry including borrowers, lenders, investors and developers. ACREL is therefore in a position to offer an unbiased opinion as to the proper resolution of the issue now before this Court.

This brief supports the position of the Respondent in this case. Due to the background of the Amici and their experience as lenders and as counsel to lenders, borrowers, and prospective purchasers at foreclosure sales, they are in a unique position to offer their expertise to this Court concerning the serious adverse impact that a reversal of the decision below would have on real estate financing.

## SUMMARY OF ARGUMENT

Congress did not define the phrase "reasonably equivalent value" contained in Section 548 of the Bankruptcy Code. The Ninth Circuit's holding below in *BFP v. Imperial Savings & Loan Association*, 974 F.2d 1144 (9th Cir. 1992) – which construed the "reasonbly equivalent value" standard to be satisfied by the price received at a noncollusive, regularly conducted foreclosure sale – is the only interpretation of these words that makes sense in light of the history and purpose of the statute.

A review of the history of Section 548 demonstrates that Congress never intended that it be used to attack noncollusive, regularly conducted foreclosure sales, but rather adopted into the Code state fraudulent conveyance law as it existed at the time of enactment. State fraudulent transfer law was and remains consistent with state foreclosure law in not permitting an attack on a foreclosure sale based upon inadequacy of price where the sale was free from collusion and inequitable conduct and conducted in accordance with the requirements of state law. The Fifth Circuit decision in *Durrett v. Washington National Insurance Company*, 621 F.2d 201 (5th Cir. 1980) went beyond the scope of Section 548, constituted an aberration from the prior law of fraudulent conveyances, and



represented an unjustified interference with carefully developed foreclosure requirements of state law.

Adoption of any other interpretation of the phrase "reasonably equivalent value" by this Court can only have a severe and negative impact on the real estate financing market. It would result in the tightening of the availability of credit, rising interest rates, and under-utilization of property. Accordingly, the decision of the Ninth Circuit should be affirmed.

## ARGUMENT

### I.

### THE NINTH CIRCUIT DID NOT ERR IN HOLDING THAT THE PRICE RECEIVED AT A NONCOLLUSIVE, REGULARLY CONDUCTED FORECLOSURE SALE SHOULD ESTABLISH REASONABLY EQUIVALENT VALUE UNDER 11 U.S.C. § 548(a)(2)(A)

#### A. Congress Did Not Expressly Provide For A Method Of Determining "Reasonably Equivalent Value" Pursuant To 11 U.S.C. § 548(a)(2)(A) And The Ninth Circuit's Holding Is A Permissible Interpretation Of That Phrase

Under Section 548 of Title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq.* (the "Bankruptcy Code"), a transfer of a debtor's interest in property may not be avoided unless the debtor "received less than a reasonably equivalent value in exchange for such transfer. . . . " 11 U.S.C. § 548(a)(2)(A). However, the phrase "reasonably equivalent value" is not defined in the Bankruptcy Code. Although it is axiomatic that the starting point of statutory interpretation is the language of the statute itself, where the statute does not define its terms, the courts must interpret those terms based on the history and overall purpose of the statute. Accordingly, since Section 548 of the Bankruptcy Code does not supply a definition for the

phrase "reasonably equivalent value," the Petitioner and Petitioner's Amici's[3] insistence that the clear language of Section 548 requires reversal of the decision below is misplaced. A review of the history and purpose of Section 548 of the Bankruptcy Code indicates that Congress never contemplated that transfers of a debtor's interest in property by means of a noncollusive foreclosure sale, conducted in accordance with procedures long established by state law, could be collaterally attacked in bankruptcy because of a claimed inadequacy of price. Rather, Congress intended to incorporate the meaning of the phrase "reasonably equivalent value" as it was understood under state law. The Ninth Circuit's decision below comports with this interpretation.

## B. Congress Did Not Intend Section 548 of the Bankruptcy Code To Apply To Noncollusive, Regularly Conducted Foreclosure Sales

### 1. Historical Basis For Section 548 Of The Bankruptcy Code

Section 548 of the Bankruptcy Code is the most recent codification of fraudulent-transfer laws, the roots of which trace back over 2,000 years to early Roman law. A brief review of that history will help explain the purpose of Section 548.

#### a. Roman Law

Under Roman law, a defrauded creditor could avoid a fraudulent conveyance by an insolvent debtor by use of a tort action known as a "Paulian Action." Max Radin, *Handbook of Roman Law* 153 (1927). Where the debtor had deliberately stripped himself of property while insolvent, suit could be brought against both the debtor and a *mala fide* purchaser

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[3] "Petitioner's Amici Brief" refers to the brief submitted by Frank Allen, Levander and Elnora McKeever, the Consumer Education and Protective Association, The Consumers League of New Jersey, and Chapter 13 Trustee Edward Sparkman as Amici Curiae in support of Petitioner. "Petitioner's Amici" refers to the proponents of the Petitioner's Amici Brief.



from the debtor as an accessory to the fraud. *Id.* However, such an action was conditioned on (1) the insolvency of the debtor, and (2) reckless disregard for the creditor's rights. *Id.* at 154.

#### b. English Law

The first Anglo-American fraudulent-conveyance laws were created in response to a perceived abuse of "sanctuary laws" which allowed debtors to transfer their property collusively and then seek sanctuary in various privileged places. 3 William Holdsworth, *A History of English Law* 305-06 (5th ed. 1966). In response to this abuse, Parliament enacted a statute permitting creditors to execute on land and chattels collusively conveyed, 50 Ed. III, c. 6 (1376), and it later passed a statute that avoided gifts of chattels made in trust with intent to defraud creditors, 3 Hen. VII, c. 4 (1476). Thus, from their inception, Anglo-American fraudulent-conveyance laws were enacted to curb the abuses of deliberately fraudulent debtors.

#### c. The Statute of 13 Elizabeth

The Statute of 13 Elizabeth, generally considered the foundation of modern fraudulent-transfer law, was enacted in 1570 and states, in pertinent part, that "covinous and fraudulent Feoffments, Gifts, Grants, Alienations, Conveyances, Bonds, Suits, Judgments And Executions . . . devised and contrived of Malice, Fraud, Covin, Collusion Or Guile, to the End, Purpose and Intent, to delay, hinder or defraud Creditors and others . . . shall be . . . utterly void, frustrate and of none Effect. . . . " 13 Eliz., c. 5 (1570). As can be seen from the language of the statute, a showing of intent to defraud was required. However, due to the fact that people do not normally make public their intent to commit fraud, it became necessary to look to the facts surrounding the transfer to uncover such intent. As a result, over time, the statute was judicially expanded to presume that certain acts or circumstances were in themselves indicative of the necessary fraudulent intent. H. W. May and W. Douglas Edwards, *The Law of Fraudulent and*

*Voluntary Conveyances* 4-5 (3d ed. 1908). Thus, even if a creditor could not show actual intent to defraud, the creditor could still meet this burden by showing the requisite circumstances or "badges of fraud" to create a presumption of actual intent to defraud. Nevertheless, proof of actual intent to defraud either by direct or circumstantial evidence was still necessary if relief was to be afforded under the statute. Accordingly, the purpose of the "badges of fraud" was not to eliminate the requirement of actual intent to defraud, but to allow proof of such intent by indirect means. *See Twyne's Case*, 76 Eng. Rep. 809 (Star Chamber 1601). This English body of law formed the foundation of American fraudulent-conveyance law.

### d. The Uniform Fraudulent Conveyance Act

In response to confusion resulting from inconsistent applications of the badges and presumptions of fraud, and from the fact that creditors were attempting to use badges of fraud to characterize all conveyances that had an adverse effect on creditors as fraudulent, the National Conference of Commissioners on Uniform State Laws approved the Uniform Fraudulent Conveyance Act (the "UFCA") in 1918. The UFCA eliminated the badges of fraud and instead grouped some of the badges of fraud into constructive frauds for which no showing of intent was required.[4] However, the intent of the UFCA was not to change the law, but to clarify it and produce the same substantive results as the Statute of 13 Elizabeth. Thus, the prefatory note to the UFCA states: "In most states, the bill if enacted will not so much change the law as clearly define what heretofore has been indefinite." UFCA, Commissioners' Prefatory Note, 7A U.L.A. 427-28 (1985). Indeed, a leading scholar of fraudulent-conveyance law stated that "[the UFCA] is a modernized statute of Elizabeth and nothing

[4] It was one of these constructive frauds that was later incorporated into American bankruptcy law by the Chandler Act of 1938 that forms the basis for challenges to noncollusive, regularly conducted foreclosure sales at issue in this case.



else." James A. McLaughlin, *Application of the Uniform Fraudulent Conveyance Act*, 46 Harv. L. Rev. 404, 405 (1933). Thus, although constructive fraud was substituted for the presumptions and badges of fraud, there was no change in the purpose of the law – to ferret out those transactions that were intended to hinder, delay or defraud creditors.

### e. Early American Bankruptcy Law

Starting with the first bankruptcy law of the United States enacted in 1800, every American bankruptcy act has included a fraudulent conveyance provision. In the Bankruptcy Act of 1898, Congress adopted, with only minor changes, the language and law of the Statute of 13 Elizabeth in Section 67d. Bankruptcy Act of July 1, 1898, ch. 541, § 67d, 30 Stat. 544 (*repealed* 1978) (the "Bankruptcy Act"). In 1938, the bankruptcy law was amended by the Chandler Act, ch. 575, 52 Stat. 9 (1938) (*repealed* 1979) (the "Chandler Act") which, but for minor changes, incorporated the provisions of the UFCA.

### f. Section 548 of the Bankruptcy Code

In 1978, Congress once again overhauled the Bankruptcy Act. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, §§ 101-151326, 92 Stat. 2549 (1978). In the 1978 revision, Section 548 replaced Section 67d with only minor changes. The principal changes were: (1) the reordering of the listing of fraudulent conveyances; (2) the substitution of "reasonably equivalent value" for "fair consideration;" and (3) the removal of the requirement that the purchaser acquire the property in "good faith." Because so few changes were made to the substance of Section 67d, there is very little commentary on Section 548 and absolutely no indication that Congress intended radical revisions to the federal law of fraudulent conveyances. Section 548 is thus a direct successor to the Uniform Fraudulent Conveyance Act, the Statute of 13 Elizabeth and the prior English and Roman laws concerning fraudulent conveyances. Over the course of centuries, the difficult-to-prove subjective test necessary to establish a

fraudulent conveyance has evolved into the wholly objective tests currently found in the UFCA and Section 548. However, the main purpose of fraudulent-conveyance laws has remained constant: prevention of inequitable transfers that would divert assets from the debtor's creditors. A noncollusive, regularly conducted foreclosure sale does not violate this policy.

### 2. For More Than 400 Years, Fraudulent-Conveyance Laws Have Not Been Applied To Noncollusive, Properly Conducted Foreclosure Sales

Foreclosure sales have never been exempt from subsequent legal challenges. Failure to comply with statutory requirements applicable to foreclosure sales or fraudulent conduct designed to chill bidding at a sale are generally grounds under state foreclosure law to set aside a foreclosure sale. *See* Nelson and Whitman, *Real Estate Finance Law* § 7.11 (2d ed. 1985). Moreover, it is clear that fraudulent-conveyance laws can be used to invalidate a transfer of the debtor's property at a mortgage sale initiated by a creditor if collusion between the debtor and the creditor can be shown. 1 Dewitt C. Moore, *A Treatise on Fraudulent Conveyances and Creditors' Remedies at Law and in Equity* § 13 at 50 (1908); 1 Garrard Glenn, *Fraudulent Conveyances and Preferences* § 214a, at 367 (2d ed. 1940); Orlando F. Bump, *A Treatise Upon Conveyances Made by Debtors to Defraud Creditors* § 237, at 276-77 (James M. Gray ed., 4th ed. 1896). Invalidation of such unfair foreclosure sales is consistent with the policy of fraudulent-conveyance laws and consequently is not surprising.

Equally unsurprising is that no reported case decided prior to *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201 (5th Cir. 1980) under English or American fraudulent-conveyance law had ever invalidated a noncollusive, regularly conducted foreclosure sale of the debtor's property.[5] Importantly,

[5] *See* Robert M. Zinman, *Noncollusive, Regularly Conducted Foreclosure Sales: Involuntary, Nonfraudulent Transfers*, 9 Cardozo L. Rev. 581, 586 (1987);



even when a foreclosure action and sale are conducted under the applicable state law and procedural rules and are free of any collusive or fraudulent conduct, state mortgage law provides an additional protection for the debtor and the debtor's creditors. Under American mortgage law, it has always been clear that a foreclosure sale could be set aside if the inadequacy of price is so great as to shock the conscience of the court. *See* 2 Charles H. Wiltsie, *A Treatise On the Law and Practice of Real Property Mortgage Foreclosure* § 647, at 1049-51 (5th ed. 1939). Against this background of state mortgage laws and fraudulent-conveyance laws, Congress incorporated fraudulent-conveyance law into the bankruptcy law. The *Durrett* court ignored 400 years of fraudulent-conveyance law and held that under Section 548 of the Bankruptcy Code a noncollusive, regularly conducted foreclosure sale could be set aside because of the inadequacy of the price obtained at the sale. Thus, a new federal measure of adequacy of price was created by the *Durrett* court without regard to the applicable mortgage doctrine that a foreclosure sale could only be set aside if the price paid is so inadequate as to shock the conscience of the Court. Thus, the decision of the Fifth Circuit in *Durrett* should be seen as an aberration from both the precedent and policy of the law of fraudulent conveyances which has developed as part of the Anglo-American legal system for over 400 years and from American bankruptcy law. The *Durrett* court's failure to cite even one case in which a noncollusive, regularly conducted mortgage foreclosure sale was invalidated as a fraudulent conveyance demonstrates that decision's abrupt departure from well-settled principles of fraudulent-conveyance law. Judge Clark, dissenting in *Abramson v. Lakewood Bank and Trust Co.*, 647 F.2d 547 (5th Cir.

*but see* Frank R. Kennedy *Involuntary Fraudulent Transfers*, 9 Cardozo L. Rev. 531, 532 (1987) ("the '*Durrett* doctrine' is not so novel. . . . "). However, all of the cases cited by Professor Kennedy in support of this statement involved facts consistent with a determination of actual fraud. None involved noncollusive, regularly conducted foreclosure sales until the *Durrett* case was decided. Zinman, 9 Cardozo L. Rev. at 584 n.19 (1987).

1981) (Clark, J., dissenting), *cert. denied*, 454 U.S. 1164 (1982), recognized this flaw in the *Durrett* holding:

> It is interesting to me that *Durrett* is the first case to treat this problem – after 90 years of bankruptcy law and mortgages of a time greater than the memory of man. It again establishes what an imaginative lawyer can do when he adds persuasion.

*Id.* at 550.[6]

### 3. The Legislative History Of Section 548 And Its Predecessors Does Not Demonstrate Any Intention To Depart Radically From Over 400 Years Of Fraudulent-Conveyance Law

An examination of the legislative history underlying Section 548 of the Bankruptcy Code, as well as its predecessors, Bankruptcy Act Sections 67d and 67e, shows that at no time did Congress ever intend radically to change existing fraudulent-conveyance law.

The Bankruptcy Act of 1898, as it existed prior to the Chandler Act, contained a virtual restatement of the Statute of 13 Elizabeth.[7] Since the Statute of 13 Elizabeth had been clarified by the UFCA in many jurisdictions, Congress amended the Bankruptcy Act in 1938 with the enactment of the Chandler Act to reflect the law of fraudulent conveyances as codified in the UFCA:

> We have condensed the provisions of the Uniform Fraudulent Conveyance Act, *retaining its substance*, and as far as possible, its language. Analysis of H.R. 12339, 74th Cong., 2d Sess. 214 (1936)

[6] During substantially the same period, if not longer, many states have had on their books a version of the UFCA and a complementary body of law regulating foreclosures.

[7] The first sentence of Bankruptcy Act Section 67e provided:

> All conveyances, transfers, assignments, or encumbrances of his property. . . . made or given by a person . . . with the intent and purpose on his part to hinder, delay, or defraud his creditors, . . . shall be void as against the creditors of such debtor. . . . Bankruptcy Act of July 1, 1898, ch. 541, § 67e, 30 Stat. 544.



> (emphasis added). *Cited in* 4 *Collier on Bankruptcy* ¶ 67.29[1], at 475 n.6 (James W. Moore et al. eds., 14th ed. 1978).
>
> . . .
>
> The UFCA was used by the drafters of the Chandler Act because it was considered to be declaratory of the better decisions of American state courts construing the Statute of Elizabeth and because, as it was believed, it would promote uniformity under the Bankruptcy Act with respect to the subject of fraudulent conveyances. 4 Robert D'Agastino et al., *Collier on Bankruptcy* ¶ 548.01, at 548-15 (Lawrence P. King et al. eds., 15th ed. 1993).

To summarize, the Bankruptcy Act of 1898 essentially reenacted the Statute of 13 Elizabeth; the UFCA clarified the Statute of 13 Elizabeth but did not intend any radical departure from it; and the Chandler Act codified the UFCA in American bankruptcy law. Throughout this process, there was never any indication that a radical departure from the prior precedent or policy of fraudulent-conveyance law was intended, or that regularly conducted foreclosure sales, in the absence of some inequitable conduct, were to be included in the coverage of the law. Indeed, when the Bankruptcy Act of 1898 and the Chandler Act were passed, it was settled American law that a foreclosure sale could not be set aside for mere inadequacy of price unless the inadequacy was so great as to shock the conscience of the Court. *Graffam v. Burgess*, 117 U.S. 180, 191-92 (1885); *See* 2 Wiltsie, *supra* at 1049-51. Congress presumably knew what the law was at the time it passed the Bankruptcy Act and the Chandler Act and presumably would have made it clear if it had intended a radical departure from that law. However, as discussed above, not only did Congress not intend to change the law drastically, it specifically intended to restate and clarify existing law.

Similarly, in 1978 when the Bankruptcy Code was enacted, Congress presumably was cognizant of the prior history of fraudulent-conveyance law and presumably was aware of the fact that no case under English or American fraudulent-conveyance law had invalidated a noncollusive,

regularly conducted foreclosure sale. Thus, if the provisions of Section 548 of the Bankruptcy Code were intended to result in a radical change from the past, one would expect that Congress would have made that intention clear. However, as previously discussed, the language of Section 548 and its legislative history evidence no such distinguishing language or intent to make such a radical change.

**4. By Incorporating State Fraudulent-Transfer Law Into The Bankruptcy Act And The Bankruptcy Code, Congress Adopted The Common State Law Understanding Of The Meaning Of "Fair Consideration" And "Reasonably Equivalent Value"**

**a. State Foreclosure Law, Designed To Balance The Interests Of Borrower And Lender, Permitted Setting Aside Of Foreclosure Sales Only For Price And Fairness Considerations Akin To Intentional Fraud**

From the inception of mortgage foreclosure law to the present day, courts and legislatures have wrestled with the problem of balancing the interests of mortgage lenders on the one hand and mortgage borrowers and their creditors on the other. *See* Steven Wechsler, *Through the Looking Glass: Foreclosure Sale As De Facto Strict Foreclosure – An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 Cornell L. Rev. 850, 855 (1985), and sources cited therein. The "equity of redemption" was developed to protect the borrower who missed payment of the mortgage on "law day;" the foreclosure process was designed to protect the mortgagee by allowing the equity court to cut off, or foreclose, the equity of redemption; the foreclosure sale was created to safeguard the borrower in a variety of ways, including providing a forum for open bidding as a means of bringing the best foreclosure sale price possible given the forced-sale nature of



the process;[8] legislatures intervened to aid the borrower with additional protective devices, including restricting or limiting the ability of the lender to obtain deficiency judgments, providing the borrower and junior creditors with rights of redemption after the sale and establishing court confirmation requirements; and the courts have been willing to set aside a foreclosure sale if it were found to be collusive or in bad faith shown by a gross price inadequacy and other evidence of fraud. *Id.* at 855-865. Because this state foreclosure law was designed by the legislatures and interpreted by the courts to balance the relative interests of borrowers and lenders, state courts refused to set aside a foreclosure sale because of claimed inadequacy of price absent circumstances amounting to intentional fraud. *See* 2 Wiltsie, *supra* at 1049-51.

When the Bankruptcy Act of 1898 and the Chandler Act were enacted, it was settled law that a foreclosure sale would not be set aside by the courts based on a claimed inadequacy of price unless the price inadequacy was so great as to shock the conscience of the court or unless additional circumstances showed that the sale was unfair. Indeed this Court in *Graffam v. Burgess*, 117 U.S. 180, 191 (1885), after reviewing existing mortgage foreclosure cases, concluded that foreclosure sales might be set aside only if:

> the inadequacy of price is so gross as to shock the conscience, or if, in addition to gross inadequacy, the purchaser has been guilty of any unfairness, or has taken any undue advantage, or if the owner of the property, or party interested in it, has been for any other reason, misled or surprised, then the sale will be regarded as fraudulent and void or the party injured will be permitted to redeem the property sold.

Thus, when the Bankruptcy Act of 1898 was enacted, it was clear that unless the conduct of the foreclosure was so

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[8] It is ironic that the foreclosure sale process, designed to protect the borrower by providing the best possible price, is the process that is being described as fraudulent and being used to attempt to overturn legitimate, noncollusive sales conducted under state law.

inequitable as to be tantamount to intentional fraud or collusion, courts would not set aside the foreclosure sale based merely on an allegation of inadequacy of price. State courts to this day follow this rule, which recognizes the price paid at a noncollusive foreclosure sale pursuant to the provisions of state law as constituting reasonably equivalent value. Only failure to comply with state foreclosure law, gross disparity of price, lack of good faith, fraud or other inequitable conduct would permit a state court to invalidate a foreclosure sale.

**b. State Fraudulent-Transfer Law Has Always Been Wholly Consistent With State Foreclosure Law, Under Which Noncollusive Mortgage Foreclosure Sales Conducted Pursuant To State Law Were Always Considered To Meet The Requirements Of Reasonably Equivalent Value**

The mortgage foreclosure law and equity jurisprudence of the respective states, not the fraudulent-conveyance laws of those states, determines the validity of a noncollusive foreclosure sale. State courts interpreting the UFCA and other state fraudulent-transfer law recognized the meaning attributed to "fair consideration" or "reasonably equivalent value" in their confirmation of foreclosure sales and never applied fraudulent-transfer law to set aside noncollusive, regularly conducted foreclosure sales as fraudulent transfers.[9] This made sense because, as discussed above, fraudulent-transfer law, including the use of badges and presumptions of fraud and the development of constructive frauds, was always intended as a means of ferreting out transactions designed to hinder, delay and defraud creditors. If a foreclosure sale were noncollusive, it would be, by definition, nonfraudulent and not within the mischief[10] for which the statute was written.

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[9] *See supra* note 5.

[10] Lord Coke's "mischief rule" for judicial interpretation of statutes is articulated in Heydon's Case, 76 Eng. Rep. 637 (Exchequer 1584). The case is excerpted and its principle discussed in Henry M. Hart, Jr. and Albert M. Sacks, *The*



State law has been so clear that noncollusive foreclosure sales conducted in accordance with state law are presumed to be for a reasonably equivalent value, that after the Fifth Circuit in *Durrett* attempted to turn existing law on its head by applying the Bankruptcy Act version of the UFCA to a noncollusive, regularly conducted foreclosure sale, the National Conference of Commissioners on Uniform State Laws specifically rejected *Durrett* in the Uniform Fraudulent Transfer Act (the Commissioner's revision of the UFCA), Unif. Fraudulent Transfer Act § 3(b), 7A U.L.A. 643 (1984), as an incorrect interpretation of both the law and the definition of reasonably equivalent value as it relates to noncollusive mortgage foreclosure sales.[11] *Id.* § 3, Comment 5.

**c. By Incorporating State Fraudulent-Transfer Law Into The Bankruptcy Act And The Bankruptcy Code, Congress Adopted The State Law As It Was Interpreted At The Time Of Enactment**

As pointed out by this Court, Congress does not write on a clean slate. *Dewsnup v. Timm*, ___ U.S. ___, 112 S. Ct. 773, 779, 116 L. Ed. 2d 903 (1992). In enacting the fraudulent transfer provisions of the Bankruptcy Act and later in the Bankruptcy Code, Congress did not write new law, but on the contrary clearly indicated its intent to incorporate state fraudulent-transfer law as it existed at the times of enactment of those laws. Reversal of the decision below would, in effect, expose every foreclosure sale to subsequent attack in a case under the Bankruptcy Code merely because, with hindsight,

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*Legal Process: Basic Problems In The Making And Application Of Law*, 1144, 1414-15 (Tentative Edition, 1958).

[11] Indeed, the National Bankruptcy Conference has proposed amending the Bankruptcy Code to overrule *Durrett*, Symposium, Bankruptcy Reform Circa 1993, ALI-ABA Conference (June 10-12, 1993). (The Conference concluded that a regularly conducted, noncollusive foreclosure sale should not be subject to attack under 11 U.S.C. § 548 and any problem of inadequacy of price at foreclosure sales should be remedied by amending the foreclosure process to ensure foreclosure sales are conducted in a commercially reasonable manner.)

the bankruptcy court, applying some non-statutory measure, finds the purchase price to be too low. This result would trample on state law without any evidence that Congress intended to pre-empt established state law.

### 5. The 1984 Amendments To The Bankruptcy Code Had No Effect On The Meaning Of Reasonably Equivalent Value Or The Application Of Fraudulent-Transfer Law To Noncollusive, Regularly Conducted Foreclosure Sales

In 1984, Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353, 98 Stat. 333, July 10, 1984 (the "1984 Amendments"). These amendments contained two clarifying amendments – adding "foreclosure of the debtor's equity of redemption" to the definition of transfers in 11 U.S.C. § 101(54), and making it clear in 11 U.S.C. § 548(a) that the fraudulent-transfer provisions applied to involuntary as well as voluntary transfers (hereinafter collectively referred to as the "Clarifying Amendments"). These Clarifying Amendments have been used by the Petitioner as a basis for arguing that they represent an intent by Congress to "change the rule" announced by the Bankruptcy Appellate Panel in *Madrid v. Lawyers Title Ins. Corp.*, 21 B.R. 424 (9th Cir. BAP 1982), *aff'd*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984), which held, as the Ninth Circuit has held in *BFP*, that the price received at a noncollusive, regularly conducted foreclosure sale satisfies the "reasonably equivalent value" standard of Section 548 of the Bankruptcy Code. As will be analyzed below, there is absolutely no basis for such a contention.[12]

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[12] Whatever the interpretation of the Clarifying Amendments may be, however, they have no relevance to the instant case. The Ninth Circuit decision is not inconsistent with them. Indeed, in order to reach the conclusion that a noncollusive, regularly conducted foreclosure sale should be deemed to be for a reasonably equivalent value under 11 U.S.C. § 548, the Ninth Circuit had to conclude that the foreclosure sale was a transfer and that Section 548 applied to involuntary transfers. At no time did the Ninth Circuit even imply an interpretation at variance with these amendments.



#### a. The 1984 Amendments Were Not Intended To Overrule The Decision In *Madrid* Or To Codify The Decision in *Durrett*

Petitioner's contention that the Clarifying Amendments were intended to overrule the Bankruptcy Appellate Panel's decision in *Madrid* is belied by the language of the Clarifying Amendments themselves, as there is absolutely no language in the Clarifying Amendments regarding the construction of the phrase "reasonably equivalent value." Surely Congress was aware of this approach to the resolution of the *Durrett* problem. However, the Clarifying Amendments do not in any way deal with the issue of defining "reasonably equivalent value." If Congress intended to do more than make clear that foreclosure sales are transfers and that Section 548 applies to involuntary transfers, and intended to legislate the reasonably equivalent value could not be presumed to be the price paid at a noncollusive foreclosure sale, it could have specifically done so. Since Congress did not do so, the Petitioner's contention that the Clarifying Amendments were designed to overrule the Bankruptcy Appellate Panel's decision in *Madrid* is wholly misplaced.

#### b. The Clarifying Amendments Were Part Of A Package Of Anti-*Durrett* Legislation And Were Not Intended To Support The *Durrett* Concept In Any Way. The Retention Of The Clarifying Amendments When The Matters Relating To *Durrett* Were Ordered Expunged From The Draft Was Purely A Scrivener's Error

To the extent that it is necessary to look to the legislative history of the Clarifying Amendments, it becomes even clearer that they were not intended to overrule *Madrid*. Rather, the history of the Clarifying Amendments makes it clear that they were only intended to ensure that intentionally fraudulent foreclosure sales did not escape the reach of Section 548, and nothing more.

As originally introduced in Congress, the Clarifying Amendments were part of a package of legislation contained in the Senate version of the 1984 Amendments designed to overrule the *Durrett* decision. Robert M. Zinman, *Noncollusive, Regularly Conducted Foreclosure Sales: Involuntary Nonfraudulent Transfers,* 9 Cardozo L. Rev. 581, 587 (1987). The main provision dealing with *Durrett* would have codified into federal law the approach taken by the Bankruptcy Appellate Panel in *Madrid* (now incorporated into the language of the Uniform Fraudulent Transfer Act) making it clear that the price received at a noncollusive, regularly conducted foreclosure sale would constitute reasonably equivalent value. *Id.* With *Durrett* rejected, the drafters decided to deal with two possible arguments: (1) that foreclosure sales were not transfers[13] or (2) that Section 548 did not apply to involuntary transfers.[14] If either of these two arguments were generally accepted, *collusive* foreclosure sales could escape the reach of 11 U.S.C. § 548. Thus, the Clarifying Amendments were merely intended to make clear that collusive foreclosure sales were within the reach of Section 548.[15]

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[13] This concern is illustrated by a law review article by Messrs. Coppel & Kann, Lawrence D. Coppel and Lewis A. Kann, *Defanging Durrett: The Established Law of "Transfer,"* 100 Banking L. J. 676 (1983) in which the authors argued that foreclosures were not transfers for fraudulent transfer purposes.

[14] This concern is illustrated by Judge Farris' concurring opinion in the Ninth Circuit's decision in *Madrid* wherein he argued that Section 548 required voluntary action by the debtor. *Madrid v. Lawyers' Title Ins. Corp. (In re Madrid),* 725 F.2d 1197, 1203-04 (9th Cir. 1984) (Farris, J., *concurring*), *cert. denied,* 469 U.S. 833 (1984).

[15] This view is even supported by *Durrett* sympathizers. *See* Frank R. Kennedy, *Involuntary Fraudulent Transfers,* 9 Cardozo L. Rev. 531, 566 (1987) ("the 1984 Amendments 'did not purport to deal with the question of whether a noncollusive, regularly conducted foreclosure sale should be deemed to be for a reasonably equivalent value.' ")



### c. The Enactment Of The Clarifying Amendments Was The Result Of A Scrivener's Error

If one looks further into the history of the enactment of the Clarifying Amendments, it becomes apparent that the Clarifying Amendments would not have been enacted but for a clerical mistake. During the debate on the 1984 Amendments, including the original anti-*Durrett* amendment, Senator Metzenbaum raised various objections to those amendments. Because of Senator Metzenbaum's objections, the short time available for debate on the floor and the necessity of passage of the 1984 Amendments to restructure the Bankruptcy Courts in light of the constitutional defects identified by this Court in *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.,* 458 U.S. 50 (1982), Senator Thurmond acquiesced in Senator Metzenbaum's objection to the inclusion of the *Durrett* amendments and ordered deletion of "provisions relating to the . . . *Durrett* issue." 130 Cong. Rec. S7617 (daily ed. June 19, 1984). However, because of a scrivener's error,[16] only the major anti-*Durrett* amendment was deleted, and the Clarifying Amendments were inadvertently left in the bill when it was enacted. Clearly, from this background it is impossible to conclude, as the Petitioner argues, that "sections 101 and 548 were amended to change the rule announced" by the Bankruptcy Appellate Panel in *Madrid.*[17]

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[16] *Cf., Union Bank v. Wolas,* ___ U.S. ___, 112 S. Ct. 527, 534, 116 L. Ed. 2d 514, (1991) (Scalia J., concurring)

[17] These events are recounted in a colloquy between Senator Dole, the Chairman of the Subcommittee of the Senate Committee on the Judiciary responsible for bankruptcy legislation at the time of the passage of the 1984 Amendments, and Senator DeConcini, who was Chairman of that subcommittee when the Bankruptcy Code was enacted. The colloquy has not been directly relied upon in this brief because it has been attacked as "post-enactment" legislative history and it is believed that the outcome of a debate on that question is not necessary to the determination of the issues here presented. However, it should be borne in mind that the colloquy did not purport to modify clear language of the statute through post-enactment legislative history. It does not attempt to undo what was written in the statute, but rather to indicate that the language of the statute

### C. "Reasonably Equivalent Value" Does Not Mean Fair Market Value In The Context Of A Foreclosure Sale

The Petitioner's Amici argue that the phrase "reasonably equivalent value" should be construed to mean "fair market value." (Petitioner's Amici Brief at 13-27.) As set forth below, this argument is not supported by the plain language of the statute and makes no practical sense in the context of the realities of a foreclosure sale.

The definition of "fair market value" typically used by appraisers when appraising a parcel of real property is as follows:

> Market Value – The highest price in terms of money which a property will bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus.
>
> Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: 1. buyer and seller are typically motivated 2. both parties are well informed or well advised, and each acting in what he considers his own best interest 3. a reasonable time is allowed for exposure in the open market 4. payment is made in cash or its equivalent 5. financing, if any, is on terms generally available in the community at the specified date and typical for the property type in its locale 6. the price represents a normal consideration for the property sold unaffected by special financing amounts and/or terms, services, fees, costs, or credits incurred in the transaction.

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should not be interpreted beyond its clear meaning, as has been urged by commentators supporting *Durrett*. *See* discussion in Robert M. Zinman, *Noncollusive, Regularly Conducted Foreclosure Sales: Involuntary, Nonfraudulent Transfers, supra*, note 5, at 592-94, and references therein to Professor Kennedy's somewhat different conclusions.



*Real Estate Appraisal Terminology* 137 (Byrl N. Boyce ed., 1975)

Amici submit that the definition of "fair market value" typically employed by appraisers in determining the value of property in an arms-length negotiated sale does not make sense in the context of a foreclosure sale. The factors that go into an appraiser's definition of "fair market value," and therefore the factors that appraisers look at when evaluating property, do not exist in a foreclosure proceeding. The appraiser's definition assumes that the "buyer and seller are typically motivated," the "price is not affected by undue stimulus," the property may be sold at any time after exposure for a "reasonable period" on the "open market," and that "financing . . . on the terms generally available in the community" is available. On the other hand, the debtor and creditor in a foreclosure proceeding are operating under a pre-determined state methodology which is inherently different than a typical sale outside of foreclosure proceedings. The debtor is not a willing seller – the property is being sold regardless of (in fact, usually against) the debtor's wishes. In a foreclosure proceeding, the property is sold on a day set by the court or pursuant to statute and the buyer must generally pay the entire sale price in cash at closing. Foreclosure sales are thus made under circumstances that bear little resemblance or relevance to the appraisers' concept of "fair market value."[18]

Since the reasonably equivalent value to be arrived at under 11 U.S.C. § 548 is the value on the date of the foreclosure sale, to ignore the effect of the economic realities of that sale, results in comparing the bid at the sale, which

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[18] Even some of the courts that support the theory that noncollusive, regularly conducted foreclosure sales may be set aside based on inadequacy of price have determined that "reasonably equivalent value" does not mean fair market value, but rather, they conclude that "reasonably equivalent value" refers to the price that can be obtained at a forced sale. *See Barrett v. Commonwealth Federal Savings and Loan Association*, 939 F.2d 20 (3d Cir. 1991); *Hood v. Williams*, 92 B.R. 648 (Bankr. E.D. Va. 1988).

must be based on those economic realities, with a hypothetical value that does not consider those realities.[19] As state courts have always recognized, the test of the validity of a foreclosure sale is its noncollusiveness and its compliance with well-developed requirements of state law, not a hindsight determination by a court as to whether the price paid represented "fair market value."

The essence of the Ninth Circuit's construction of the reasonably equivalent value requirement to mean the *same* as the consideration received at a noncollusive, regularly conducted foreclosure sale, is to recognize that the best evidence of value is what bona fide buyers are willing to pay at a state authorized public sale rather than what an appraiser hypothesizes to a bankruptcy court as to what the value had been at the time of the transfer. The Ninth Circuit's approach is the only approach that makes sense when the economic realities of a foreclosure sale are considered and it harmonizes the law of foreclosures with the law of fraudulent conveyances without doing violence to the policies underlying either body of law.

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[19] This conclusion is not intended as support for the proposition that properties acquired by mortgagees at foreclosure sales are generally acquired for less than their market value. More often than not, mortgagees lose money on resale of foreclosed properties (see text at notes 26 and 27 *infra*). This is because properties with substantial equity value above the mortgage generally do not go to foreclosure. Borrowers normally are aware of their precarious financial condition long before default and there is normally a significant period of time before foreclosure is commenced and thereafter before sale of the property during which time the borrower can sell the property and preserve its equity. Most mortgagees sincerely believe that property will not go to foreclosure if the value exceeds the mortgage balance in any meaningful degree. *Wechsler, supra* at 853. Amici's concern, however, is that the imposition of an unrealistic requirement that fair market value be received in a forced foreclosure sale places every foreclosure purchaser at a severe disadvantage and encourages *Durrett* attacks on the foreclosure process.



## II.

## APPLICATION OF THE CONSTRUCTIVE FRAUD PROVISIONS TO NONCOLLUSIVE FORECLOSURE SALES CONDUCTED IN ACCORDANCE WITH STATE LAW MAKES NO SENSE WHEN PRACTICAL REALITIES ARE CONSIDERED

### A. Adoption Of The *Durrett* Principle Would Have A Severe Adverse Effect On The Mortgage Market, The Availability Of Credit And The Effective Use Of Real Property

The *Durrett* principle, if adopted by this Court and thereby made applicable nationwide, can only have a severe and negative effect on the entire mortgage market. It would result in more cautious lending by institutions; the tightening up on the availability of credit; increased interest rate costs to borrowers; reduced bids at foreclosure sales to reflect the *Durrett* risk; and unreasonable under-utilization of property as purchasers at foreclosure sales wait out the applicable holding period[20] until the risk of a *Durrett* attack has passed.[21] These consequences can only be exacerbated by a

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[20] Section 548 of the Bankruptcy Code limits fraudulent transfer attack to the year prior to bankruptcy. However, a fraudulent transfer may also be attacked by the trustee by using state fraudulent-transfer law under § 544(b), which gives the trustee the rights of a creditor under state law against whom the lien is invalid. State fraudulent-transfer law is not conditioned on bankruptcy and thus, unless the state has adopted the Uniform Fraudulent Transfer Act, which rejects the *Durrett* principle as an incorrect interpretation of fraudulent-transfer law, the only limitation on its use in an attempt to attack mortgage foreclosures is the state statute of limitations for fraud. While state courts have not applied fraudulent-transfer law to noncollusive, regularly conducted foreclosure sales in the past, it is not clear that bankruptcy courts would feel constrained to adhere to that precedent if this Court were to reject the reasoning of the decision below and hold that "reasonably equivalent value" means something other than what had been previously understood. Thus in many states, foreclosed property could be exposed to a possible *Durrett* attack for many years.

[21] Provisions of the Bankruptcy Code designed to alleviate these risks are insufficient. For example, § 548(c) provides that upon setting aside a transfer, the transferee may have "a lien" to the extent of the amount bid at the foreclosure sale, and § 550(d) provides that the transferee may have "a lien" to the extent any

severe real estate recession, banking institutions struggling with insolvency, and major financial institutions shifting lending away from real estate mortgages.

The Amici support the thorough and well-reasoned analysis of the harmful and negative impact the *Durrett* principle will have on all participants in real estate transactions contained in the Amici brief of the Federal Home Loan Mortgage Corporation, the Mortgage Bankers Association of America, and the American Land Title Association.

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improvement it made increased the value of the property transferred. These remedies are available only if the court determines that the transferee acted in "good faith." Given decisions such as *In re Littleton*, 888 F.2d 90 (11th Cir. 1989) where the court questioned the good faith of any mortgagee bidding less than the court's hindsight determination of what value had been, these provisions do not give the mortgagee/purchaser much confidence. Furthermore, the lien for improvements is limited to the increase in the value of the property resulting from the improvements. This requires a subjective determination of the amount by which a particular expenditure increased property value and appears to ignore the fact that some repairs and other expenses are necessary merely to keep the property from depreciating further in value. No remedy is given to the foreclosure sale purchaser who sells the property after the sale to a good faith purchaser. In such a case, the remote purchaser is free from attack and the original foreclosure sale purchaser will be responsible for paying the difference between the bid price and what the court determines to have been the value of the property. *See In re Coleman*, 21 B.R. 832 (Bankr. S.D. Tex. 1982) where the foreclosed property had been sold by the transferee, after acquisition, for the same price bid at the foreclosure sale. The court nevertheless found the price was less than 28% of the value of the property and indicated that the mortgagee would be called upon to pay that difference if the remote purchaser had been in good faith.



**B. Response To The Policy Arguments ~~Asserted~~ In The Petitioner's Amici Brief**

**1. The Shuchman[22] "Empirical Study" On The Effect Of The *Durrett* Rule Is Inaccurate And Represents An Attempt To Buttress Counter-Intuitive, Politically-Oriented Conclusions**

The Petitioners, and especially the Petitioner's Amici, rely inordinately on the "empirical study" prepared by Professor Philip Shuchman, which purports to "prove" the dubious proposition that increased costs and risks to lenders associated with the *Durrett* rule have no effect on costs or availability of financing. This difficult task is attempted through the use of inconclusive and inaccurate "empirical" evidence.

**a. Incorrect Theory And Analysis**

The underlying premise of the Shuchman study is that lenders will decrease mortgage lending when the federal court covering a particular state adopts the *Durrett* principle, and contrariwise, lenders will increase lending activity when the governing court rejects *Durrett*. This premise is incorrect when applied to jurisdictions rejecting *Durrett*. Where a jurisdiction, not having previously adopted *Durrett*, rejects an

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[22] Philip Shuchman's "empirical" study, *Data on the Durrett Controversy*, 9 Cardozo L. Rev. 605 (1987) is cited throughout the Petitioner's Amici Brief to prove, *inter alia*, that general adoption of the *Durrett* principle will have no effect on the cost or availability of mortgage financing. The reasoning and accuracy of this study was strongly questioned in the very next issue of the same law review. Robert M. Zinman, *Durrett Data: Shucking the Husks from the Grain*, 9 Cardozo L. Rev. 1013 (1988). Yet the refutation is neither cited nor rebutted anywhere in the Petitioner's Amici Brief. Similarly, Professor Frank R. Kennedy's article, *Involuntary Fraudulent Transfers*, 9 Cardozo L. Rev. 531 (1987), is cited extensively in the Petitioner's Amici Brief. However no mention was made of the fact that the Kennedy article was part of a two-article debate on the subject of foreclosure sales as fraudulent transfers in the same issue of the law review, the other article disputing the contentions of the Kennedy article. Robert M. Zinman, *Noncollusive, Regularly Conducted Foreclosure Sales: Involuntary, Nonfraudulent Transfers*, 9 Cardozo L. Rev. 581 (1987).

attempt to apply that rule, the decision represents no change in the law and should have *no* effect on mortgage lending practices. California is an example of the study's faulty reasoning. Shuchman, *supra* at 633. The study presumes that after the decision of the Ninth Circuit in *Madrid,* rejecting a fraudulent transfer attack on a foreclosure sale, that interest rates would decline and loans would increase, an incongruous result since the Ninth Circuit had never been a *Durrett* jurisdiction.[23] What makes the Shuchman study's reliance on California especially egregious is that the Ninth Circuit decision in *Madrid* actually represented a disappointment for lenders because it did not adopt the Bankruptcy Appellate Panel's determination that the price received at a noncollusive, regularly conducted foreclosure sale should be deemed to meet the reasonably equivalent value standard. In *Madrid,* the affirmance was on other grounds.[24] Thus, if anything, according to Professor Shuchman's premise, the results should have had a negative rather than positive effect on mortgage lending.

Other examples of the distortions embodied in the Shuchman study included the creative classification of states such as New York, Pennsylvania and North Carolina as pro- or anti-*Durrett* based on the existence at the time of one or two bankruptcy court decisions without even District Court consideration of the issue, much less consideration by the appropriate Courts of Appeals. *Id.* at 630-32. Lenders have never contended that one bankruptcy court decision would have the effect of stopping mortgage lending or increasing interest

[23] Indeed, over a year before the Ninth Circuit decision in *Madrid,* the Bankruptcy Appellate Panel in that case had rejected the *Durrett* principle and held that a noncollusive, regularly conducted foreclosure sale would be deemed to be for reasonably equivalent value. It is no surprise therefore that the empirical data failed to show improvement in the mortgage market after the Ninth Circuit's decision since the decision did not represent a meliorating change in the governing law.

[24] The *Madrid* court determined that the transfer in that case had taken place at the time the mortgage was recorded which was more than a year before the bankruptcy, and the court did not reach the question of whether a noncollusive, regularly conducted foreclosure sale meets the reasonably equivalent value requirement of Section 548.



rates. What lenders contend is that if *Durrett* becomes generally accepted (such as by the approval of the *Durrett* principle by this Court), it can only have the effect of increasing mortgage lending costs nationwide and this will result in more cautious underwriting of borrowers' credit and increased interest rates to reflect the increased risk.

### b. Questionable Measuring Years

Even if the classification of jurisdictions in the Shuchman study were correct, the results would still be inaccurate because of arbitrary use of measuring years. For example, the Shuchman study considers the date of the 1980 Fifth Circuit decision in *Durrett* as the crucial date in Texas, whereas appeal of that decision continued until certiorari was denied in a contemporaneous case in 1982. *Abramsom v. Lakewood Bank & Trust Co.,* 647 F.2d 547 (5th Cir. 1981), *cert. denied,* 454 U.S. 1164 (1982). In fact, in the year after the denial of certiorari, the Shuchman study itself shows that the increase in residential lending in Texas dropped to less than half of the national increase and that in 1984 residential lending decreased by almost 12% in Texas while residential lending actually increased nationally in 1984. Shuchman, *supra* at 628.[25]

### c. One Factor Analysis

Even if the Shuchman study had been carefully and neutrally prepared, its conclusions could be faulted because of its assumption that mortgage lending costs and practices can be based on one factor alone. This represents a denial of the fact that economic conditions, government monetary policy, restrictions imposed by regulatory agencies, as well as costs of operation and bankruptcy risks are all factors bearing on the mortgage market. A change in one factor may offset a change in another, but when it comes to the bottom line, each

[25] The southwest was in a real estate recession at the time and this may have affected the results. Nevertheless, the figures clearly do not support the Shuchman conclusions.

of the factors has an effect on the availability and cost of mortgage financing.

Clearly, if expenses of mortgage lenders increase, interest rates will be affected; if bankruptcy rulings cause these costs to increase, lenders will more carefully underwrite borrowers' credit; and, if mortgage lending becomes more difficult, investment dollars will flow into less difficult investments, particularly from investors such as life insurance companies which regularly invest in corporate and government securities.

### 2. The Petitioner's Amici Brief Incorrectly Cites Other Studies As Support

Professor Wechsler's empirical study of mortgage foreclosures in New York is cited as support for the carefully crafted statement "In reality, the foreclosure sale purchasers obtain a significant windfall when property is sold for less than a full fair value." (Petitioner's Amici Brief at 45.) The statement hardly needs support of citations. If property is sold for less than its value, it follows that a purchaser who does not have an investment in the property exceeding its purchase price will reap a benefit.[26] What the Petitioner's Amici Brief does not disclose, however, is that the Wechsler study concludes that mortgagees (when they are the "successful" bidders at foreclosure) usually suffer a *loss* on resale of foreclosed properties and thus receive no windfall.[27]

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[26] This brief does not contest that proposition. Indeed it is fully consistent with the reasoning in this brief that if financing and foreclosure costs increase because foreclosure sales are set aside, mortgagees will be more circumspect in extending credit and that the cost will be passed on to borrowers in the form of higher interest rates. See refutation of Shuchman study in section B1 of Part II of this brief.

[27] The study showed that all resales of foreclosed properties, both residential and commercial, produced an average loss of almost $14,000 per property. *Wechsler, supra* at 870. The mortgagee was made whole in only 44% of the cases. *Id.* As pointed out in Robert Zinman, *Noncollusive, Regularly Conducted Foreclosure Sales: Involuntary, Nonfraudulent Transfers*, 9 Cardozo L. Rev. 581, 598, n.67 (1987), the figures understate the true extent of the mortgagee's loss



To support its proposition that foreclosures normally produce a windfall, the Petitioner's Amici Brief (at 45) also cites to the Kennedy article, the Mixon article, John Mixon, *Deficiency Judgments Following Home Mortgage Foreclosure: An Anachronism that Increases Personal Tragedy, Impedes Regional Economic Recovery, and Means Little to Lenders*, 22 Tex. Tech. L. Rev. 1, 33-4 (1991), and the Skilton article, Robert H. Skilton, *Assessing the Mortgage Debtor's Personal Liability*, 90 U. Pa. L. Rev. 440, 444-45 (1941-42).

Professor Kennedy's article was not an empirical study. However, while he made no mention of this issue on the page cited by Petitioner's Amici, he did imply that the Wechsler study was support for the assertion in footnote 196 that normally the mortgagee receives a windfall on foreclosure, stating that the scenario is "so prevalent that it is the focus of a recent empirical study and recommendations for reform in foreclosure procedures." Kennedy, *supra* at 578 n.196. While it is true that the Wechsler study dealt with mortgage foreclosures, that study clearly concluded that mortgagees lose money on the sale of foreclosed properties. Wechsler, *supra* at 870.

Both the Mixon and Skilton articles dealt with the issue of deficiency judgments, not with mortgagee windfalls. Nominal bids at foreclosure sales are criticized in those jurisdictions where they can result in deficiency judgments based on the nominal bid. Professor Mixon at the page cited was discussing statutes designed to limit or eliminate liability for a deficiency. Professor Skilton also attacked nominal bidding because of the possibility of large deficiency judgments. Neither claimed that the mortgagee usually receives a windfall because the value of the property exceeds the mortgage balance. Deficiency judgments are not involved in the determination of this case, and this brief does not take issue with the

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because profit would seem to have been determined by comparing the total amount due the mortgagee on foreclosure with the resale price. Apparently not included were lost opportunity costs, maintenance expenses, repairs, brokers' fees, attorneys fees, etc. *Id.*

professors' conclusion supporting state legislation that limits deficiency judgments.

### 3. The Case At Bar Does Not Involve A Tax Sale

The case at bar involves the issue of whether a noncollusive and regularly conducted *mortgage foreclosure sale* can be deemed by the court to be for reasonably equivalent value. Two of the Petitioner's Amici attempt to relate this case to tax sales of their homes. A decision affirming the Ninth Circuit will not control a decision on whether the constructive fraud provisions of Section 548 are applicable to tax sales of property. The Ninth Circuit did not hold that the amount received at a tax sale equalled reasonably equivalent value. Tax sales are not mortgage foreclosures and are therefore distinguishable from the case at bar. For example, unlike mortgage foreclosures, tax sales are for that portion of tax obligations in default, which bears no direct relation to the value of the property being sold, while in almost all cases, a mortgage is based on a significant percentage of the value of a property. Furthermore, if the tax sales' price inadequacies described by Petitioner's Amici had been found in mortgage foreclosure sales, they could have been struck down before the bankruptcy petitions were filed under the traditional rule of nonbankruptcy mortgage foreclosure law that foreclosure sales may be set aside when the price inadequacy is so great as to shock the conscience of the court.

## CONCLUSION

The decision of the Ninth Circuit should be affirmed.

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Respectfully submitted,

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